

COMMONWEALTH OF KENTUCKY  
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE APPLICATION OF PENDLETON	)	
COUNTY WATER DISTRICT SEEKING	)	CASE NO. 92-204
APPROVAL TO INCREASE ITS RATES	)	
FOR WATER SERVICE	)	

O R D E R

On July 14, 1992, Pendleton County Water District ("Pendleton") filed its application for Commission approval of a proposed increase in its rates for water service. Commission Staff, having performed a limited financial review of Pendleton's operations, has prepared the attached Staff Report containing Staff's findings and recommendations regarding Pendleton's proposed rates. All parties should review the report carefully and provide any written comments or requests for a hearing or informal conference no later than 15 days from the date of this Order.

IT IS THEREFORE ORDERED that all parties shall have 15 days from the date of this Order to provide written comments regarding the attached Staff Report or requests for a hearing or informal conference. If no request for a hearing or informal conference is received, then this case will be submitted to the Commission for a decision.

Done at Frankfort, Kentucky this 6th day of November, 1992.

PUBLIC SERVICE COMMISSION

  
For the Commission

ATTEST:



Executive Director

COMMONWEALTH OF KENTUCKY  
BEFORE THE PUBLIC SERVICE COMMISSION

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PUBLIC SERVICE  
COMMISSION

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THE APPLICATION OF PENDLETON	)	
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APPROVAL TO INCREASE ITS RATES	)	
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STAFF REPORT

Prepared By: Jack Scott Lawless, CPA  
Public Utility Financial  
Analyst  
Water and Sewer Revenue  
Requirements Branch  
Rates and Tariffs Division

Prepared By: John Geoghegan  
Public Utility Rate  
Analyst  
Communications, Water  
and Sewer Rate Design Branch  
Research Division

STAFF REPORT  
ON  
PENDLETON COUNTY WATER DISTRICT  
CASE NO. 92-204

A. Preface

On July 14, 1992, Pendleton County Water District ("Pendleton") filed its application with the Kentucky Public Service Commission ("Commission") seeking approval to increase its tariffed rates by 6.5 percent, an increase in annual operating revenues of \$25,710.

In order to evaluate the requested increase, the Commission Staff ("Staff") chose to perform a limited financial review of Pendleton's operations for the test period, the twelve month period ending December 31, 1991. Jack Scott Lawless, CPA, of the Commission's Division of Rates and Tariffs, conducted the review at Pendleton's office in Falmouth, Kentucky. John Geoghegan, of the Commission's Research Division, performed his review at the offices of the Commission in Frankfort, Kentucky.

The findings of the field review have been reduced to writing in this report. Mr. Geoghegan is responsible for the sections related to operating revenues and rate design. The remaining sections of this report were prepared by Mr. Lawless. Based upon the findings of this report, Staff recommends that Pendleton be allowed to increase its normalized operating revenues by 14 percent, an increase in annual operating revenues of \$60,369.

Scope

The scope of the review was limited to obtaining information to determine whether test period operating revenues and expenses were representative of normal operations. Insignificant or immaterial discrepancies were not pursued and are not addressed herein.

During the course of the review, Pendleton was advised that all proposed adjustments to test year expenses must be supported by some form of documentation and that all such adjustments must be known and measurable as well as fair, just and reasonable.

B. Analysis of Operating Revenues and Expenses

Normalized Revenue

In its application, Pendleton reported test-year revenues in the amount of \$366,238. Of this amount, \$358,493 was from water sales and \$7,745 was from other operating revenues. In schedule E of its application, Pendleton County provided usage and billing data for the test period of 1991. Based on this information, Staff calculated test year operating revenue from water sales of \$358,493. Pendleton County's 1991 annual report on file with the Commission shows operating revenue from water sales of \$358,587, a difference of \$94. Staff concurs with the usage and billing data provided in Pendleton County's application and has used the revenue produced by the billing analysis in its determination of revenue requirements.

Pendleton County received a Purchased Water Adjustment during the test year which increased normalized revenue by \$2,628. Also during the test year, the addition of 178 new customers increased normalized revenue by \$69,708. Normalized revenue from sales during the test year is therefore \$430,829, and total revenue is \$438,574.

#### Operating Expenses

Pendleton reported operating expenses of \$351,623 for the test year which it proposed to increase by \$17,421 using an inflation factor. Staff is of the opinion that inflation is not a known and measurable factor for which pro forma adjustments should be made; therefore, Staff recommends that Pendleton's expense adjustments be disallowed for the purposes of setting rates in this case. Staff has adjusted test year operating expenses in the amount of \$76,113. Staff's adjustments are shown on Appendix B attached to this report and are discussed in the following sections of this report.

#### Salaries and Wages

Pendleton reported test year salaries and wages of \$78,127. Pendleton employed a part time and a full time employee during the test period whose total annual salaries were not reflected in test year salaries and wages expense. Staff has calculated pro forma salaries and wages expense to be \$97,971 based on Pendleton's current salary and wage levels and test-year overtime. A detailed calculation of the pro forma salaries and wages is shown on

Appendix C attached to this report. Staff has made the appropriate adjustment to test-year salaries and wages of \$19,844<sup>1</sup>.

Employee Pensions and Benefits

Pendleton provides retirement benefits to its full time employees based on a 5 percent contribution rate. Staff has made an adjustment of \$1,322<sup>2</sup> to the test period retirement expense of \$2,622 in conjunction with the salaries and wages adjustment, resulting in a pro forma expense of \$3,944.

Also, Pendleton reported test year health and life insurance expense of \$7,925. Staff has adjusted this amount by \$2,907<sup>3</sup> to reflect the most current monthly premiums paid by Pendleton.

<sup>1</sup>	Pro forma Salaries and Wages	\$ 97,971
	Less: Test year	<u>(78,127)</u>
	Adjustment	<u>\$ 19,844</u>
<sup>2</sup>	Pro forma Salaries and Wages	\$ 97,971
	Less: Salaries and Wages not Subject to Retirement	<u>(19,080)</u>
	Pro forma Salaries and Wages Subject to Retirement	78,891
	Times: Five percent	<u>5%</u>
	Pro forma Retirement	3,944
	Less: Test year	<u>(2,622)</u>
	Adjustment	<u>\$ 1,322</u>
<sup>3</sup>	Monthly Premium	\$ 903
	Annualize	<u>12</u>
	Pro forma	10,832
	Less: Test year	<u>(7,925)</u>
	Adjustment	<u>\$ 2,907</u>

Purchased Water

Pendleton reported test year purchased water expense of \$132,138. Staff has adjusted this amount by \$42,768<sup>4</sup> so that the pro forma expense reflects the 108,074,309<sup>5</sup> normalized gallons needed for sale at the current rates charged by its suppliers, the City of Falmouth and Campbell County Water District. The City of Falmouth charges Pendleton \$77.65 for the first 50,000 gallons purchased and \$1.76 per thousand for any usage over 50,000 gallons, while Campbell County Water District charges them \$1.54 per thousand.

Insurance

Pendleton reported test year general liability and worker's compensation insurance of \$6,427. Pendleton is currently paying \$7,691 annually for these insurance premiums; thus, Staff has made the appropriate adjustment to test year insurance expense of \$1,264<sup>6</sup>.

<sup>4</sup>	Pro forma Purchased Water	\$ 174,906
	Less: Test year	<u>(132,138)</u>
	Adjustment	<u>\$ 42,768</u>
<sup>5</sup>	Normalized Gallons Sold per	
	PSC Research Division	97,328,322
	Add: Water used by Pendleton	<u>330,000</u>
	Gallons to be used	97,658,322
	Divide by: 1-unaccounted for water %	<u>90.3622%</u>
	Gallons needed to be purchased	<u>108,074,309</u>
<sup>6</sup>	Property and Liability	\$ 3,875
	Worker's Compensation	<u>3,816</u>



Depreciation

Pendleton reported test year depreciation expense of \$66,248. Test year depreciation includes one month of depreciation expense related to construction that was placed into service in December, 1991. Staff has adjusted test year depreciation expense by \$7,243<sup>7</sup> so that pro forma depreciation expense reflects twelve months of depreciation taken on the utility plant in service as of the end of the test year.

Taxes Other Than Income Taxes

Taxes other than income taxes expense has been adjusted in conjunction with the salaries and wages adjustment. An adjustment of \$765<sup>8</sup> is necessary to reflect FICA taxes at the pro forma salary levels.

	Pro forma	7,691
	Less: Test year	<u>(6,427)</u>
	Adjustment	<u>\$ 1,264</u>
7	Pro forma monthly Depreciation	\$ 6,124
	Annualize	<u>12</u>
	Pro forma	73,491
	Less: Test year	<u>(66,248)</u>
	Adjustment	<u>\$ 7,243</u>
8	Pro forma Salaries	\$ 97,971
	Less: Amount not subject to FICA	<u>(14,400)</u>
	Pro forma subject to FICA	83,571
	Times: Tax rate	<u>7.65%</u>
	Pro forma	6,393
	Less: Test year	<u>(5,628)</u>
	Adjustment	<u>\$ 765</u>

C. Revenue Requirements Determination

The approach frequently used by this Commission to determine revenue requirements for water districts with outstanding bond issuances such as Pendleton is a 120 percent debt service coverage on the average annual debt service payment. Staff recommends the use of this approach plus the recovery of the principal and interest payments on Pendleton's outstanding automobile capital lease and bank loan used for the purchase of a backhoe. By utilizing this approach, Staff has calculated an increase in normalized operating revenues of \$60,369, as discussed below.

Capital Lease

Pendleton purchased a 1991 Chevrolet Truck under the Municipal Lease Agreement with General Motors Acceptance Corporation on September 25, 1991. The original principal balance of this lease was \$14,196.87 at an annual interest of 8 percent. The monthly payment made by Pendleton is \$456.13 which is \$5,474 annually. Although Pendleton did not receive prior Commission approval to assume this debt as required by KRS 278.300, Staff has included this amount in its calculation of Pendleton's revenue requirements as Staff deems this a prudent expenditure.

Bank Loan

Pendleton has an outstanding demand note from The Farmers Bank which was incurred for the purchase of a backhoe. This demand note is rolled over every year and is therefore not subject to KRS 278.300 so long as it is retired within 6 years of its origination.

As of December 31, 1991 the outstanding balance of this note was \$23,868. At an annual interest rate of 8.75 percent, Pendleton's monthly payment is \$500 which is \$6,000 annually. Staff has included this in its calculation of Pendleton's revenue requirements, as follows:

Adjusted Operating Expenses	\$427,736 <sup>9</sup>
Average Annual Debt Service	52,381 <sup>10</sup>
20 Percent DSC	10,476 <sup>11</sup>
Annual Capital Lease Payment	5,474 <sup>12</sup>
Annual Bank Loan Payment	<u>6,000<sup>13</sup></u>
Total Revenue Requirement	502,067
Less: Normalized Metered Water Revenue	(430,829)
Other Operating Revenue	(7,745)
Pro forma Interest Income	<u>(3,124)</u>
Required Increase	<u>\$ 60,369</u>

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<sup>9</sup> See Appendix B

<sup>10</sup> Averages based on the years (1993-1995)

5% Revenue Bonds	\$ 15,750
3 5/8% Revenue Bonds	18,146
6 1/2% Revenue Bonds	<u>18,485</u>

Total Average Annual Debt Service	<u>\$ 52,381</u>
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<sup>11</sup> Average annual Debt Service \$ 52,381  
Times: Debt Service Coverage Rate 20%

Debt Service Coverage (DSC)	<u>\$ 10,476</u>
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<sup>12</sup> Monthly lease payment \$ 456  
Annualize 12

Annual Recovery	<u>\$ 5,474</u>
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<sup>13</sup> Monthly loan payment \$ 500  
Annualize 12

Annual Recovery	<u>\$ 6,000</u>
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Pendleton included in its proposed revenue requirements \$4,000 for the recovery of a pension buyout and \$20,000 for the recovery of past years' deficits. The pension buyout was not a definite expenditure as of the time of Staff's field review. It was merely an estimate made by Pendleton which does not adhere to the known and measurable requirement implemented by this Commission and should therefore be disallowed for rate-making purposes in this proceeding. Furthermore, the inclusion of either of these items in revenue requirements would be retroactive rate-making as it would be placing past cost of operations on current system users. Staff is of the opinion that retroactive rate-making should not be allowed by this Commission and any item constituting retroactive rate-making should not be included in the calculation of revenue requirements.

#### D. Rate Design

Pendleton County filed a schedule of present and proposed rates in its application. Staff is of the opinion that the present rate design is reasonable. Pendleton County did not propose to change its present rate design; therefore, any change in revenue will be added to the existing rate structure. Pendleton County's proposed rates will produce \$391,324 annually in revenue. Appendix A outlines the rates based on the increase recommended by Staff of \$60,369 and will produce \$491,198 in annual water sales.

Staff Report  
PSC Case No. 92-204  
Page 10 of 10

E. Signatures

Jack Scott Lawless, CPA  
Prepared By: Jack Scott Lawless, CPA  
Public Utility Financial  
Analyst  
Water and Sewer Revenue  
Requirements Branch  
Rates and Tariffs Division

John Geoghegan  
Prepared By: John Geoghegan  
Public Utility Rate  
Analyst  
Communications, Water and  
Sewer Rate Design Branch  
Research Division

APPENDIX A  
TO STAFF REPORT CASE NO. 92-204

The Staff recommends the following rate be prescribed for customers of Pendleton County Water District.

Monthly Rates

First 2,000 gallons	\$10.75 (Minimum Bill)
Next 3,000 gallons	5.00 per 1,000 gallons
Next 10,000 gallons	4.90 per 1,000 gallons
Over 15,000 gallons	4.73 per 1,000 gallons

APPENDIX B  
TO STAFF REPORT CASE 92-204

Pendleton County Water District  
Statement of Adjusted Operations

	Test Year	Adjustments	Pro forma Present Rates
Operating Revenue			
Metered Water Revenue	\$358,493	\$72,336	\$430,829
Other Operating Revenues	7,745		7,745
Total Operating Revenue	366,238	72,336	438,574
Operating expenses			
Operation and Maintenance			
Salaries and Wages	98,127	19,844	97,971
Employee Pensions and Benefits	11,004	1,322	
		2,907	15,233
Purchased Water	132,138	42,768	174,906
Fuel for Power Production	8,823		8,823
Materials and Supplies	21,198		21,198
Contractual Services-Accounting	4,800		4,800
Contractual Services-Legal	1,500		1,500
Contractual Service Other	5,528		5,528
Rental of Bldg.	3,234		3,234
Transportation	5,053		5,053
Insurance	6,427	1,264	7,691
Regulatory Commission fee	497		497
Miscellaneous	1,418		1,418
Total Oper. and Maint.	279,747	68,105	347,852
Depreciation	66,248	7,243	73,491
Taxes Other Than Income Taxes	5,628	765	6,393
Total Operating Expenses	351,623	76,113	427,736
Net Operating Income	14,615	(3,777)	10,838
Other Income			
Interest Income	6,818	(3,694)	3,124
Income Available for Debt Service	\$21,433	(\$7,471)	\$13,962
	=====	=====	=====

Pendleton County Water District  
Calculation of Pro forma Salaries and Wages

Employee	Regular Hours	Rate per Hour	Regular Pay	Overtime Hours	Rate per Hour	Overtime Pay	Total Pay
Operations Manager			\$30,500				\$30,500
Office Manager	1,950	\$7.50	14,625				14,625
Maintenance Person #1	2,080	8	16,640	177.5	\$12	\$2,130	18,770
Maintenance Person #2	2,080	7	14,560	41.5	10.5	436	14,996
Part-time	780	6	4,680				4,680
Sub-total			81,005			2,566	83,571
Commissioners							14,400
Pro forma Payroll							\$97,971